NEOS®

A CAPCO COMPANY

TRANSFORM YOUR COSTLY CLOSED-BLOCK PORTFOLIO INTO A PROFITABLE ASSET SUITE

New technologies are helping insurers analyze unwieldy life and annuity portfolios

CONTENT

INTRODUCTION: A FRESH LOOK AT CLOSED BLOCKS

Many insurers look at their life and annuity closed-block portfolios with unease. These holdings are filled with products that underperformed – acquired assets that disappointed, were crowded out by newer offerings, or failed due to regulatory change. Without a future, they were closed to new subscribers and maintained primarily for premium renewals and associated assets.

Befitting their non-glamorous status, closed blocks, which can be many decades old, are hidden away on legacy systems, maintained by operations and IT professionals heading into retirement, and stored on hardware that is disconnected from the digital enterprise.

Out of sight, out of mind. But not out of trouble.

For insurers who neglect to actively manage them, these portfolios can drive up operating costs, reduce financial flexibility, increase risk across a number of fronts, and absorb critical management and customer service bandwidth at a time when it is needed most.

There is another risk: lost opportunity. Closed blocks (also known as closed books) are populated by loyal customers long familiar with the brand, people who could be prime targets for other offerings but are neglected at the tail end of the product graveyard.

Now, thanks to technology advances, a robust market for acquiring closed-block portfolios, and increasing expertise among third parties for squeezing profit from them, the time has arrived for insurers, private equity firms, and others in the value chain to reassess their runoff strategies and move forward.

For companies that are successful, orphaned blocks can be modernized in a digital policy management system where policyholders can engage with new products and services. Underlying assets can be re-leveraged, modernized, and monetized. And if the right decision for the insurer is to sell off closed-block accounts to outside investors, there has likely never been a better time to find takers willing to pay handsomely for their castoffs.

In this paper, we explore challenges that insurers face maintaining closed-block portfolios, and the overarching mistake they make in their strategy. We outline a process for how firms can extract value from closed blocks by analyzing their portfolios to make strategic decisions on how to revitalize or dispose of them asset by asset.

Here is our main message: Closed blocks are unique assets that require their own strategy, apart from how other life and annuity products are managed. The common mistake made by insurers is the lack of a unique strategy to manage them. If given sharp focus and custom solutions, these products can create new energy with customers and spin off material financial benefits. Ignoring closed-block opportunities will cost insurers increasingly over time.

CHALLENGES:

MANAGING CLOSED BLOCKS IS EXPENSIVE AND CARRIES INCREASING RISK

In some respects, runoff blocks of life insurance and annuities are easy for management to ignore. With little effort, at least on the surface, they provide insurers with nominal cash flows resulting from premium renewals and asset investments at reliable margins.

But the truth is that managing legacy blocks can create costly problems that build over time. These include:

Higher administrative and operating expenses. These products may be closed to new subscribers, but they still need continued actuarial, accounting, and compliance service oversight and support. As a result, operating and administrative costs per policy keep rising as closed blocks run off.

Legacy systems and technology hurdles. Closed-block policies are often managed on aging policy administration systems housed on legacy platforms. This setup can be efficient – at least measured by unit cost per policy – but that comes up short in a modern business environment where agility and flexibility are required. Legacy systems are labor intensive and hinder compliance, analytics, and product development. Meanwhile, the experienced IT staff supporting these systems are retiring; COBOL and other legacy programmers are in their 50s, 60s, and even 70s. There is significant technology debt and risk in supporting legacy blocks.

Customer service and retention roadblocks. Insurers generally do not invest much to improve the servicing quality for closed blocks, so the customers' journey managing their policies can be time consuming and frustrating. It is not uncommon, for example, to find processors in contact centers using "terminals" to connect to old admin systems supporting a product a policyholder is calling about. In addition, older admin systems are likely not API-enabled, which limits access to data that would otherwise allow effective digital marketing to and self-service by policyholders. A stagnant portfolio with dissatisfied customers is a recipe for brand erosion, retention issues, and negative market perceptions.

Regulatory and legal scrutiny. In managing closed blocks, insurers face additional challenges implementing regulatory changes. Escalating reserve requirements, for example, lock up capital and add pressure to profitability. Legal liability can grow as products age, and new opt-in and privacy requirements are difficult to implement in legacy platforms.

The net effect on insurers from these challenges is that valuable resources are tied up servicing closed, low-margin accounts, reducing overall firm competitiveness and innovation.

With industry competition increasing from non-traditional players and digital startups, along with soaring consumer expectations and a shifting regulatory environment, now is the time for insurers to take a closer look at their low-value products and services – in particular, their unprofitable closed-block policies.

SOLUTIONS:
UNLOCKING THE VALUE OF CLOSED BLOCKS

Several potential solutions exist to free insurers from the drag these accounts can generate. The primary alternatives are selling closed-block policies and assets to a third party; outsourcing administration and claim services to a third party; and focusing on in-house management through modernization and strategic partnerships.

In this environment, we do not consider "Do Nothing" a wise or sustainable decision.

ALTERNATIVE 1:
SELLING CLOSED-BLOCKS TO SPECIALIST PLAYERS OR CLOSED-BLOCK CONSOLIDATORS

Insurers are increasingly inclined to sell off closed blocks to eliminate the challenge of servicing runoff business. This solution can be the most pragmatic and viable option for many insurers. It's an active market, so buyers may be willing to pay premium prices for another insurer's assets.

The downside: By selling their closed-block businesses, insurers sever long-existing client relationships, missing out on opportunities to cross-sell or market new offerings. In addition, insurers lose the chance to leverage their current assets and turn unprofitable blocks into profitable ones, with minimal to moderate incremental investment near term.

Outright sales of products can also create funding revenue to explore new business opportunities. Never has it been more important for the industry to innovate and introduce new products at scale that meet growing consumer demands.

HARTFORD SELLS TALCOTT FOR $2.05B

For many insurers, selling their closed-block business might be the most expeditious way to proceed. The Hartford Financial Services Group thought so, when in 2018 it agreed to sell its runoff life and annuity businesses, Talcott Resolution, to an investor group led by Cornell Capital LLC, Atlas Merchant Capital LLC, TRB Advisors LP, Global Atlantic Financial Group Ltd., Pine Brook, and J. Safra Group.

Believed to be one of the largest such deals on record, Hartford received $2.05 billion, divvied up in cash, a preclosing cash dividend, debt included as part of the sale, and a 9.7% ownership interest in the acquiring company. Hartford Investment Management Co. would continue to manage a significant majority of Talcott Resolution's investment assets for an initial five-year term.

Chairman and CEO Christopher Swift said the sale would strengthen Hartford's property and casualty, group benefits, and mutual funds businesses. "We also expect the sale will improve our future ROE and earnings growth profile and enhance the company's financial flexibility," Swift said at the time. (In 2021, investment firm Sixth Street acquired Talcott Resolution Life Insurance Company, formerly Hartford's life and annuity operations, for an undisclosed sum.)

ALTERNATIVE 2:
OUTSOURCING ALL OR PART OF ACCOUNT ADMINISTRATION

Selecting partners to take on account administration preserves existing client relationships, stabilizes operating expenses (no need to invest capital in servicing), and frees up human capital for more productive work.

Outsourcing has traditionally provided lower-cost talent in onshore, nearshore, and offshore locations, such as India and the Philippines. "Follow the sun" talent availability can extend service windows and improve turnaround times and productivity. Outsourcing can provide flexible staffing capabilities for seasonal demand surges (e.g., annual enrollments) and changing demographic requirements (e.g., long-term care claims). Finally, outsourcing offers an opportunity to consolidate vendor contracts, maximize budgets, and streamline governance, reporting, and performance management. A servicing contract could include policy administration, claims processing, contact center, and complaint handling.

Outsourcing partners manage the portfolio and all its support systems, achieving economies of scale by servicing multiple clients simultaneously to spread their costs. Outsourcing engagements can be priced and invoiced on a time-and-materials basis, per full time equivalent (FTE), or according to transactions or policy participant counts. Common types of outsourcing in the United States include platform-based outsourcing, personnel, and platform-based outsourcing, and personnel-only outsourcing.

The downside: A potential headache with the outsourcing alternative occurs while transferring customer data from a legacy system to the outsourcer's system. Although this process has undergone significant improvement over the last 10 years, it is rarely straightforward, fast, or inexpensive, and breakdowns can cause ill-will with customers and increase the cost of the program.

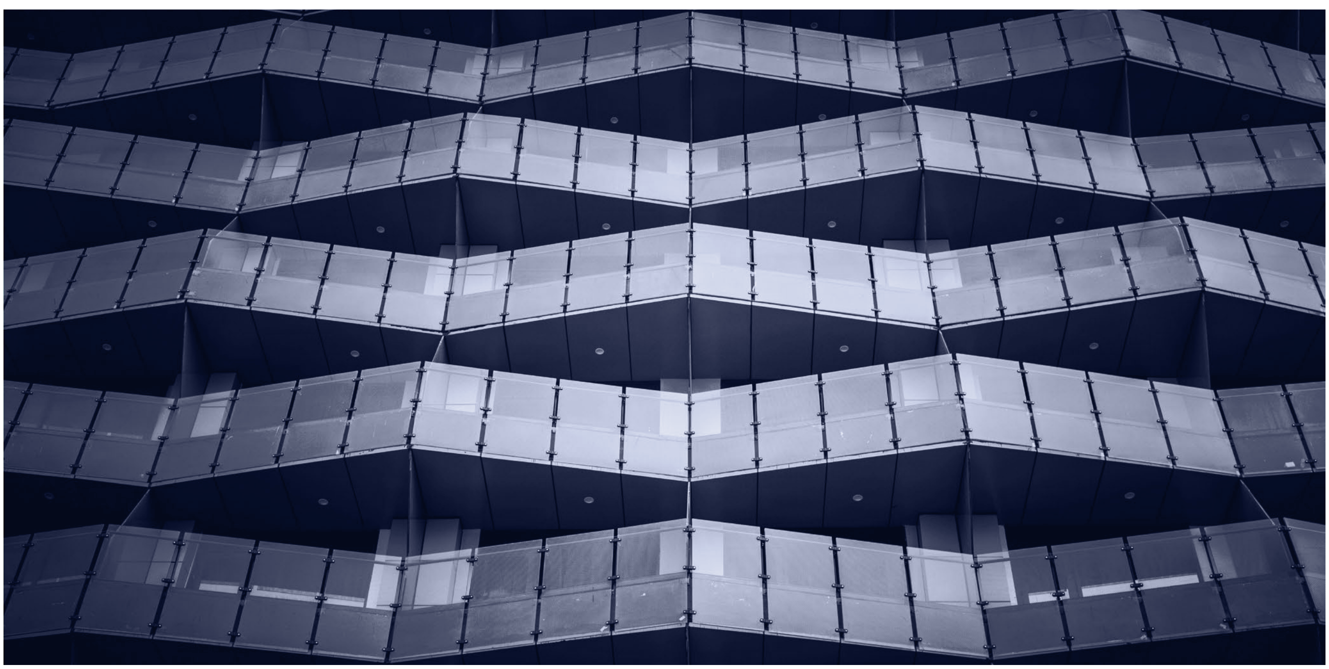
Here's another worry: There is no guarantee that an administrative partner's systems can stay up to the task in the future. In fact, the outsourcer may face the same technology trials relative to antiquated systems as the insurer.

ALTERNATIVE 3:
IN-HOUSE MANAGEMENT THROUGH STRATEGIC PARTNERSHIPS AND TECHNOLOGY MODERNIZATION

In this scenario, the insurer maintains control of closed blocks while moving most or all its policies and the program to a more modern, digital policy administration system. Insurers carefully select one or a few strategic partners – third-party administrators, SaaS vendors, or IT vendors – and create a hybrid model that focuses on platform replacement or modernization, rebadging or talent globalization, and sharing in early investments, ongoing expenses, and profits and margins throughout the program.

This hybrid model enables insurers to improve cost-efficiencies, achieve better customer engagement, and generate cross-sell and upsell opportunities. At a deeper level, it can consolidate or improve legacy systems while injecting the latest tools and technologies such as solution accelerators, configurable applications, and modern platforms. Constituent experiences are digitized and continually updated. The model can drive sustainable savings of 25 to 30%. In short, this model offers growth and profitability that are not achievable through more traditional, non-hybrid solutions.

The downside: Significant time and expense is incurred. In-depth due diligence, an integrated operations and technology solution, and a thoughtfully crafted long-term plan are required. Business sponsors will need to win organizational commitment, including ongoing C-level sponsorship. Assumption of financial and regulatory exposure are also required. It's a big bet.



WHERE TO GO FROM HERE: REASSESSMENT

Which option is best for you? You don't know yet.

That's because closed-block programs are often hidden from view on systems tucked away at the back of the backroom, unseen by analytical tools, infested with inconsistent and ill-formatted data, and accessible to only a few specialists.

To plot the best course, it's time for insurers to put their closed-block portfolios under the microscope. Each product must be evaluated on its own merits to determine its ideal future to maximize value while reducing cost and minimizing risk. That cost-benefit evaluation must include systems and operations expenses as well as the opportunity costs insurers pay to maintain them.

The action plan we recommend: Evaluate, Rationalize, Transform.

Evaluate. Finding out what is known and not known about the current runoff business starts the discovery path. Begin with a deep due diligence or audit of current holdings. (This can be a cumbersome process given how buried or fragmented these records can be in legacy systems.) An inventory should yield everything from the number of products and policy counts to the types and quantities of service requirements and requests to the cost of maintaining the supporting platforms and systems.

Additional evaluation steps could include gathering stakeholder input, program scoping, and evaluating IT assets and capabilities. Let's take a closer look at stakeholder interviews, for example.

Stakeholders from all impacted functional areas should list their priorities relative to portfolio modernization in several dimensions, starting with alignment to business strategy. Questions to draw out these priorities would include, "Products with the highest volume of manual service events should be converted first," or "Products with the highest cross sell profitability potential should be converted first."

The next step, evaluating IT assets, allows the insurer to calculate where digital resources are lacking to modernize, and the potential cost of modernization. Evaluating IT capabilities is crucial to understanding what you should do in-house versus outsourcing to specialists. Answering these critical questions lets an insurer know if they have the IT readiness and maturity to embark on a full-on modernization effort, or if they should turn to strategic partners for much of this expertise, and their tools, platforms, intellectual property (IP).

Rationalize. With audit results in hand, the evaluation turns to data analysis, synthesis, planning, and mapping.

This process sheds light on the risk, cost, value, and complexity of each product or block – determining the most beneficial strategy to move forward. Solutions should align with an insurer's unique approach to the market.

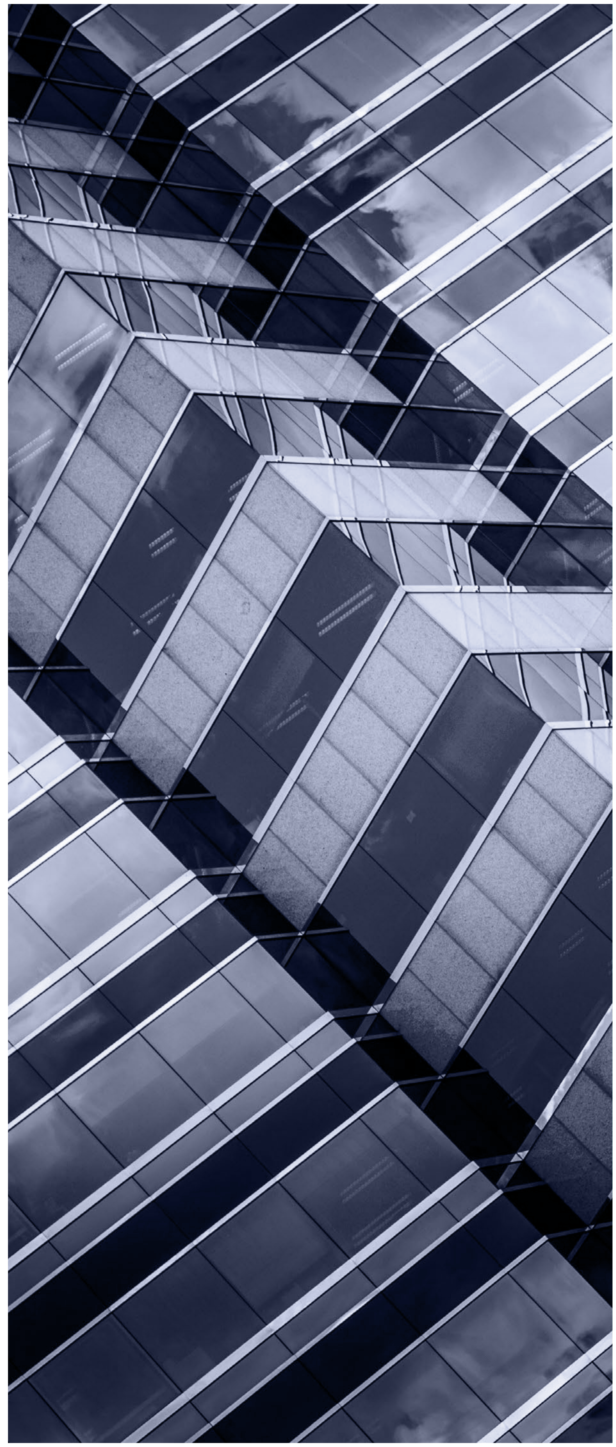
Score existing products on a range of factors such as strategic need, volume, IT cost, transformability, and future profitability, which allows quick identification of blocks that are good candidates for modernization.

As an example, our own scoring process, the FutureFirst Product Scorecard, includes modernization options for each block or plan code, potential impacts to business services and operations, and architectural recommendations to include how to deal with history, data quality, and business requirements.

Transform. Scores and recommendations from the earlier steps can be used to write a modernization playbook that includes program prioritizations, vendor selection, and viewing assets through the eyes of potential acquirers. To the later point, an investment bank may have little interest in running a closed insurance business but is attracted to managing the underlying assets. Meanwhile, another player in the closed block value chain, say a policy administration vendor, has the technical wherewithal to manage closed-block portfolios at lower cost per policy than the insurer can manage.

The resulting scores and recommendations can be used to determine a viable disposition for each product – divest, outsource, migrate to a new platform, roll up or redesign, sunset – as well as an effective systems strategy.

In the end, there is no one-size-fits-all solution. Some products in an insurer's inventory may be best suited for a sell-off while others should be modernized or outsourced — or a combination of all three. One answer, for example, might be to keep the current policy administration system in place but modernize the digital channels that connect those systems to customers, agents/brokers, and operations personnel.



POTENTIAL BENEFITS OF REASSESSING CLOSED BLOCKS

Even if insurers do nothing but the evaluation and rationalization exercises, they will emerge with an unflinching view of both the potential value and the current costs of their portfolio. They will be able to decide whether to transform or simply continue to manage these blocks of business. Conducting this assessment will help to prevent investing in technology modernization to accommodate products that should not move or will not be profitable.

There are two additional benefits of doing this type of assessment. This is a data-driven exercise that is repeatable. With this repeatability comes the ability to create a baseline so that the assessment can be run each time a block is closed or a new product instantiated into the portfolio. Your assessment capability, as long as it is consistent, can give you a current and historical disposition for your portfolio

But rewards will be much greater for insurers that take the next step, transform, to rethink their closed-block strategy. Let's look at some of the potential benefits.

Reduced operating costs. Outsourcing accounts enables the insurer to sunset a legacy system and admin platforms, and all the support that goes into maintaining them. For every dollar saved in closed-block servicing costs, several dollars can usually be released from reserves, funds that can be redistributed to more profitable endeavors. Savings often range from 25% to 30% within the first two to three years.

Digital automation of core processes. Transitioning "transformable" blocks to modern third-party platforms or modernizing a legacy platform enables more efficient and user-friendly administration of closed and open blocks. For example, digital innovation injected into these systems enables straight-through processing of key billing, claims, and policy-servicing processes. Technology supports automation using robotic process automation, machine learning, and digital workflows. A centralized repository makes it easier to manage and leverage data. Simplified governance and consistent metrics facilitates more effective management, continued consolidation, and cost reduction. This adds up to more accurate data, lower admin costs, and the potential to reduce or redeploy headcount.

Platform optimization. Platforms, especially older systems with closed-block responsibilities, can be full of inefficient systems and applications, technology redundancies, and even security risks. Reducing technical debt across the platform can optimize infrastructure usage and ease migration to scalable cloud technologies.

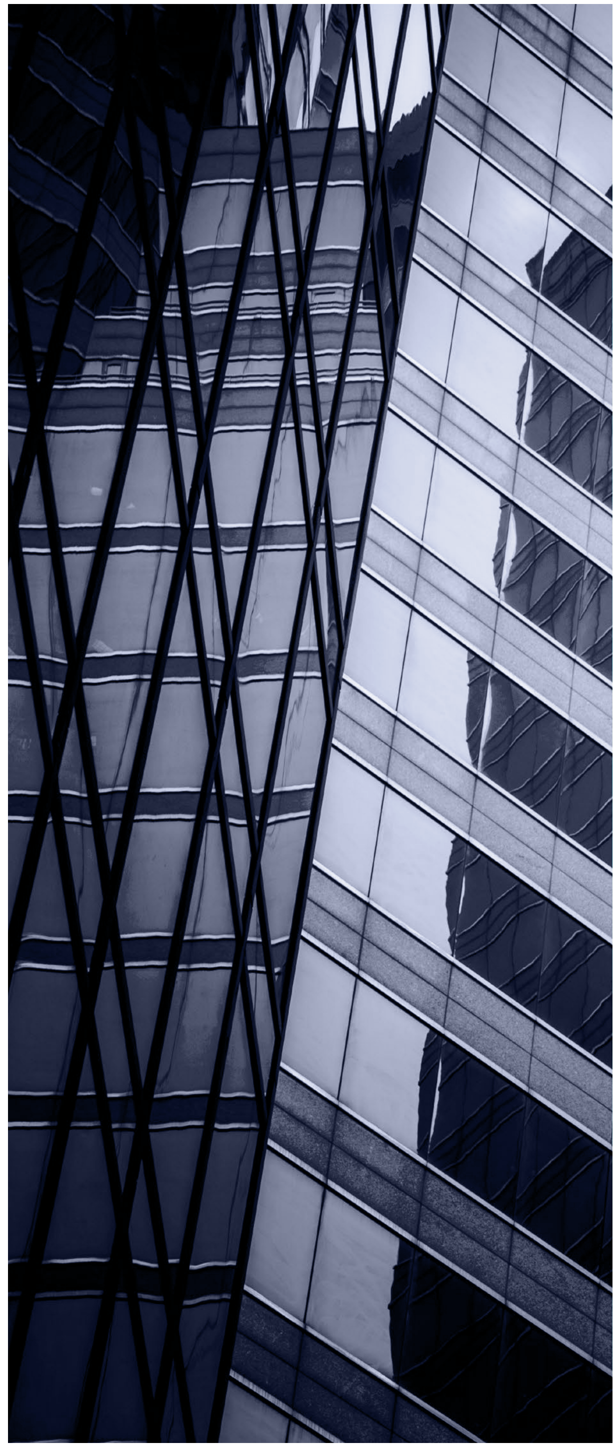
Improved focus on growth opportunities. Reducing attention on closed blocks frees up management, business, and IT talent to focus on areas with greater growth potential or on innovation that creates strategic advantage. Just think how many times an insurance actuary must deal with closed-block compliance, product testing, or pricing versus devoting time on design of the next product or an acquisition effort?

De-risked balanced sheets. The longer a policy is administered, the greater the risk increases as regulations evolve or economic conditions deteriorate. These shocks can include reserve strengthening and capital calls, unexpected price increases from outsourcing vendors, capital markets exposure, and regulatory compliance challenges. Effective corrective action on these issues requires high-level business transparency and IT integration that many closed-block programs lack.

Digital customer journeys. Customer experiences around closed-block accounts can be dismal, unlike any other experience they have with the company. Digitizing enables self-service through digital channels and other service enhancements such as AI-enabled chatbots and other advanced customer interfaces. An improved customer experience will pay off with higher retention and renewal rates.

Data cleansing and integration. Streamlining the data model introduces the possibility of master data management and better governance. Digital tools can be turned on to clean data models of legacy idiosyncrasies and eliminate data-driven workarounds. Once integrated, this data can contribute to enterprise-wide business intelligence efforts.

In the case study mentioned above, The Hartford's divestiture approach generated several benefits. By shifting operations, IT staff, and a suite of technology platforms to the acquiring investment group, Hartford reduced operating costs and simplified the technology landscape. They de-risked and simplified their balance sheets. And with the infusion of capital and a focus on growth, they were able to make large moves like the acquisition of Navigators later that year.



SUMMARY:
THE TIME FOR ACTION IS NOW

Closed-blocks are unique assets that require their own strategy, in sync with, but apart from how other life and annuity products are managed. If given targeted solutions and careful management, these products can create new energy with satisfied customers and positive financial returns. Ignoring the closed-block reality will only drag like an anchor on good products and an insurers' larger P&L and balance sheet.

It's not only insurers who should take advantage of this moment to evaluate their closed-block strategies. All players in the ecosystem — private equity, investment banks, IT and business management service providers — should refresh their closed-block strategies.

Over the last decade, strong growth in the closed-block business was partly a reflection of low interest rates and principle-based reserving regulations on insurers. The macroenvironment is changing once again. Players in the value chain should revisit their assumptions about what will drive this market over the next three to five years and calibrate their business strategy accordingly.

SOURCE

1. Maitree Christian. "The Hartford to sell Talcott Resolution to investor group in $2.05B deal." December 4, 2017. S&P Global Market Intelligence. https://www.spglobal.com/marketintelligence/en/news-insights/trending/ay5ufsdu4wvfki_fbbezvg2

AUTHORS

Stephen Talnose, Executive Director, stephen.talnose@capco.com
Eric Fairchild, Managing Principal, eric.fairchild@capco.com
Christopher Dickinson, Managing Principal, christopher.dickinson@capco.com
Ernst Renner, Partner, ernst.renner@capco.com

ABOUT NEOS

NEOS is a recognized leader in helping global Insurance and Financial Services organizations drive transformative change. Specializing in Life, Annuities, Retirement, Employee Benefits, Property & Casualty, and Wealth Management, NEOS provides management consulting and delivery services that enable clients to solve strategy, distribution, operations, data, and technology challenges. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk, reduce costs, and enhance controls. Since our founding, our expert teams of seasoned data, strategy, technology and business management consultants have continued to apply a holistic approach to understanding your strategic priorities and desired business outcomes. With creative thinking and practical implementation, we ensure that the services and solutions we provide merge seamlessly with your company culture. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

To learn more, visit our website at **www.neosllc.com** or follow us on **Twitter** and **LinkedIn**.

WORLDWIDE OFFICES

APAC
Bangalore
Bangkok
Gurgaon
Hong Kong
Kuala Lumpur
Mumbai
Pune
Singapore

EUROPE
Berlin
Bratislava
Brussels
Dusseldorf
Edinburgh
Frankfurt
Geneva
London
Munich
Paris
Vienna
Warsaw
Zurich

NORTH AMERICA
Charlotte
Chicago
Dallas
Hartford
Houston
New York
Orlando
Toronto
Tysons Corner
Washington, DC

SOUTH AMERICA
São Paulo

WWW.CAPCO.COM

[NEOS] A CAPCO COMPANY

JN_4034